



# Latin America's Economic Perspectives

People's Bank of China, 22 September 2006

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# Outline

1. Latin America in a globalized world
2. Short term prospects for Latin America
3. Chile
4. Medium term challenges for Latin America

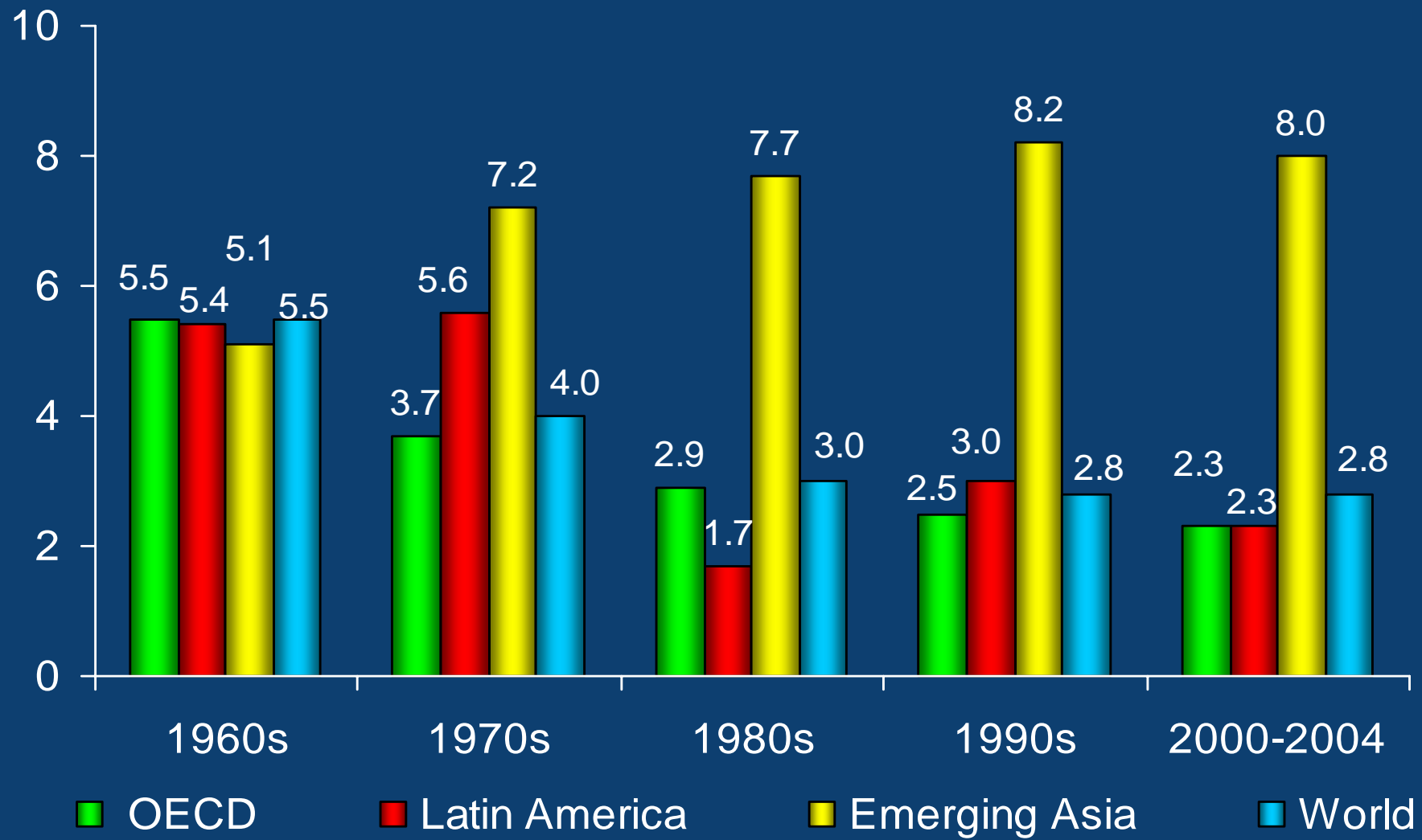
# 1. Latin America in a globalized world



# Historical context

- Growth in Latin America was slower and more volatile than in other emerging economies, especially from East Asia.
- Debt crisis of early 1980s uncovered severe macroeconomic imbalances and structural problems, motivating reforms that focused on:
  - ▲ Integration to the rest of the world;
  - ▲ Macroeconomic stability;
  - ▲ Increased market competition and liberalization;
  - ▲ New role for the State.

# Economic Growth (%)



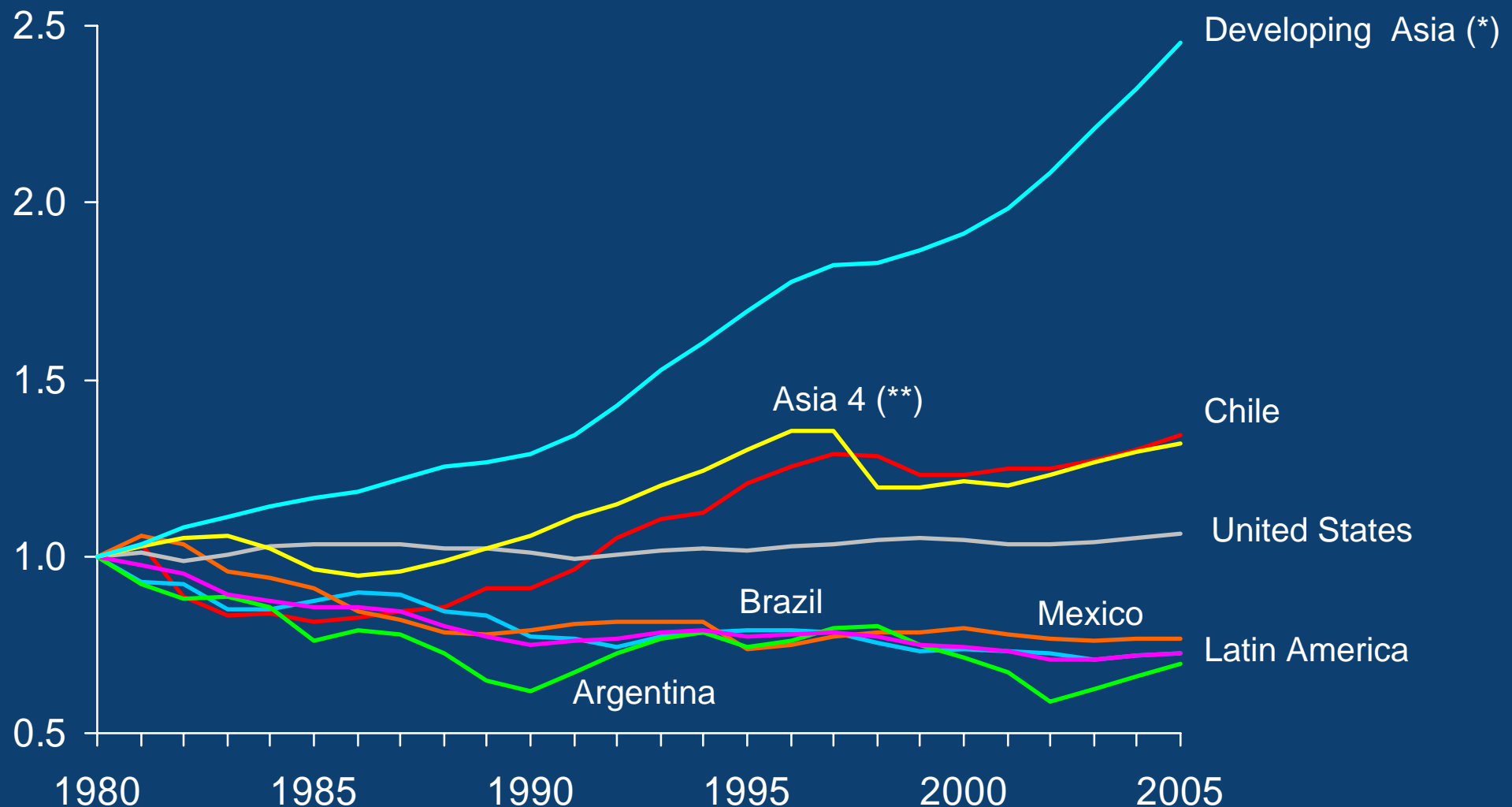
Source: WDI (2006).

# Poor results

- The objective was to accelerate growth, attain macroeconomic stability, and thus achieve substantial improvements in social indicators.
- Nevertheless, sustainable growth was not achieved because of:
  - ▲ Persistent income gaps with respect to G-7;
  - ▲ Big macroeconomic crises, mainly with a fiscal origin, exacerbated in some countries because of financial disturbances;
  - ▲ Modest and unequal poverty reduction.

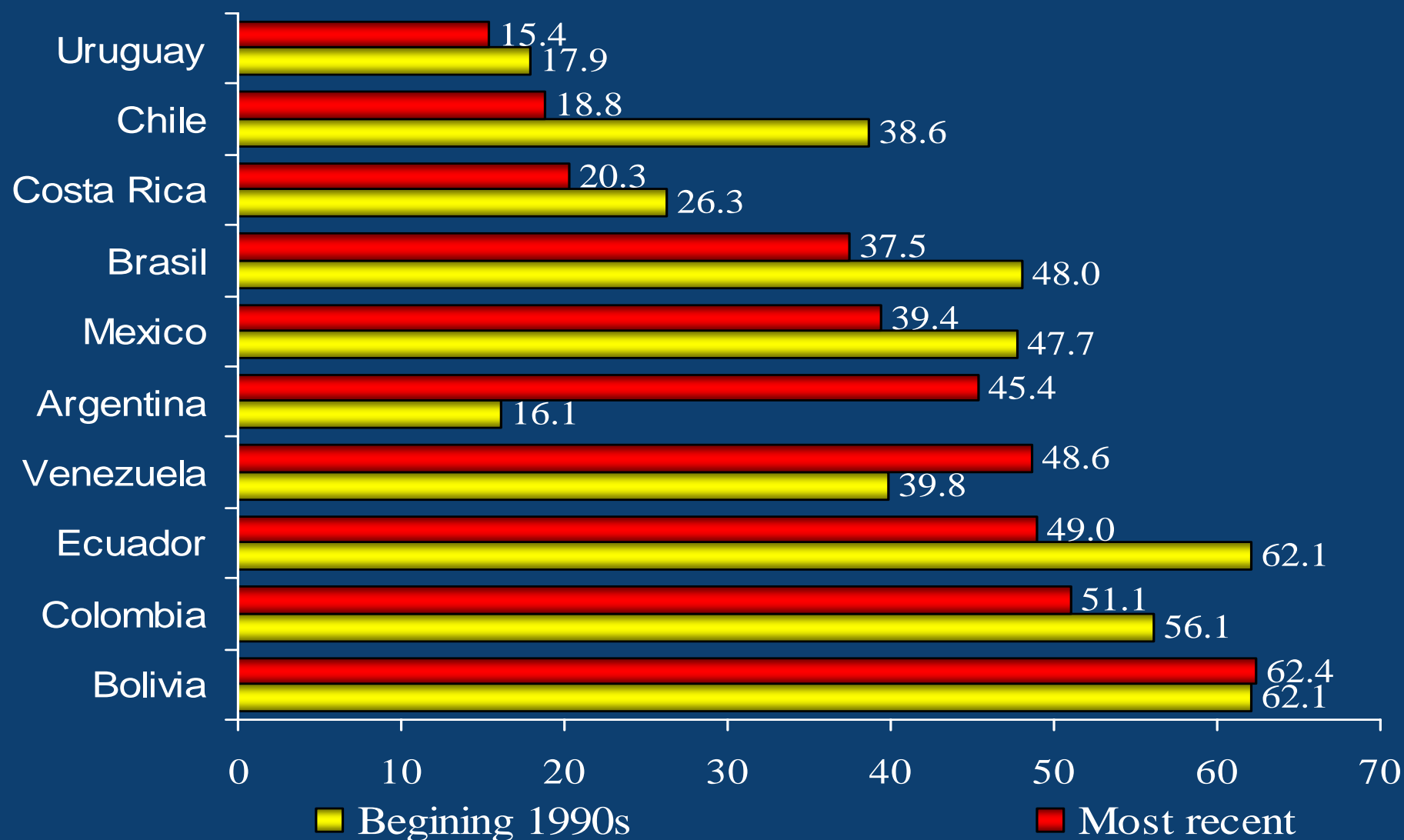
# Relative Per Capita Output

*(per capita GDP over per capita GDP of G-7, PPP; 1980=1)*



(\*) Includes China and India (\*\*) Considers Malaysia, Indonesia, Thailand and Philippines.  
Source: Own calculations.

# Poverty Rate (%)



Note: Most recent refers to 2002 or 2003, depending on the country.

Sources: Cepal(2004) and Mideplan (2005).

## 2. Short term prospects for Latin America



# Short term prospects

- In recent years, important progress has been made in the region:
  - ▲ Inflation has been reduced;
  - ▲ Efforts to increase fiscal prudence, more flexible exchange rate systems and newly introduced inflation-targeting monetary policy regimes have been implemented in several countries.

# Inflation in Latin America

## (%)

	1980s	1990-94	1995-99	2000-04	2005	2006 (f)
Argentina	565.7	515.7	0.8	8.3	9.6	12.9
Bolivia	1383.1	13.4	7.4	3.0	5.4	3.4
Brazil	332.3	1690.2	19.4	8.7	6.9	4.9
Chile	21.4	17.5	6.0	2.8	3.1	3.8
Colombia	23.4	26.3	18.0	7.3	5.0	4.7
Mexico	69.1	16.3	24.5	6.0	4.0	3.5
Paraguay	20.5	23.3	9.7	9.1	6.8	7.4
Peru	481.3	1607.4	8.4	2.4	1.6	2.7
Uruguay	57.6	76.4	21.4	10.6	5.9	5.5
Venezuela	23.1	41.0	53.8	20.8	15.9	11.7
Average LAC	150.6	263.5	17.0	7.9	6.3	5.8

(f) Forecast.

Source: WEO (April 2006).

# Short term prospects

- Economic benefits of these reforms have been enhanced by a good external scenario:
  - ▲ High growth rates, balanced between regions of the world;
  - ▲ Strengthened commodity prices:
    - Latin American economies are mainly commodity exporters;
    - Merchandise exports have grown faster than in other emerging economies.
- The region grew more than 4% in 2005 and a similar rate is expected for this year.

# Commodity Exports

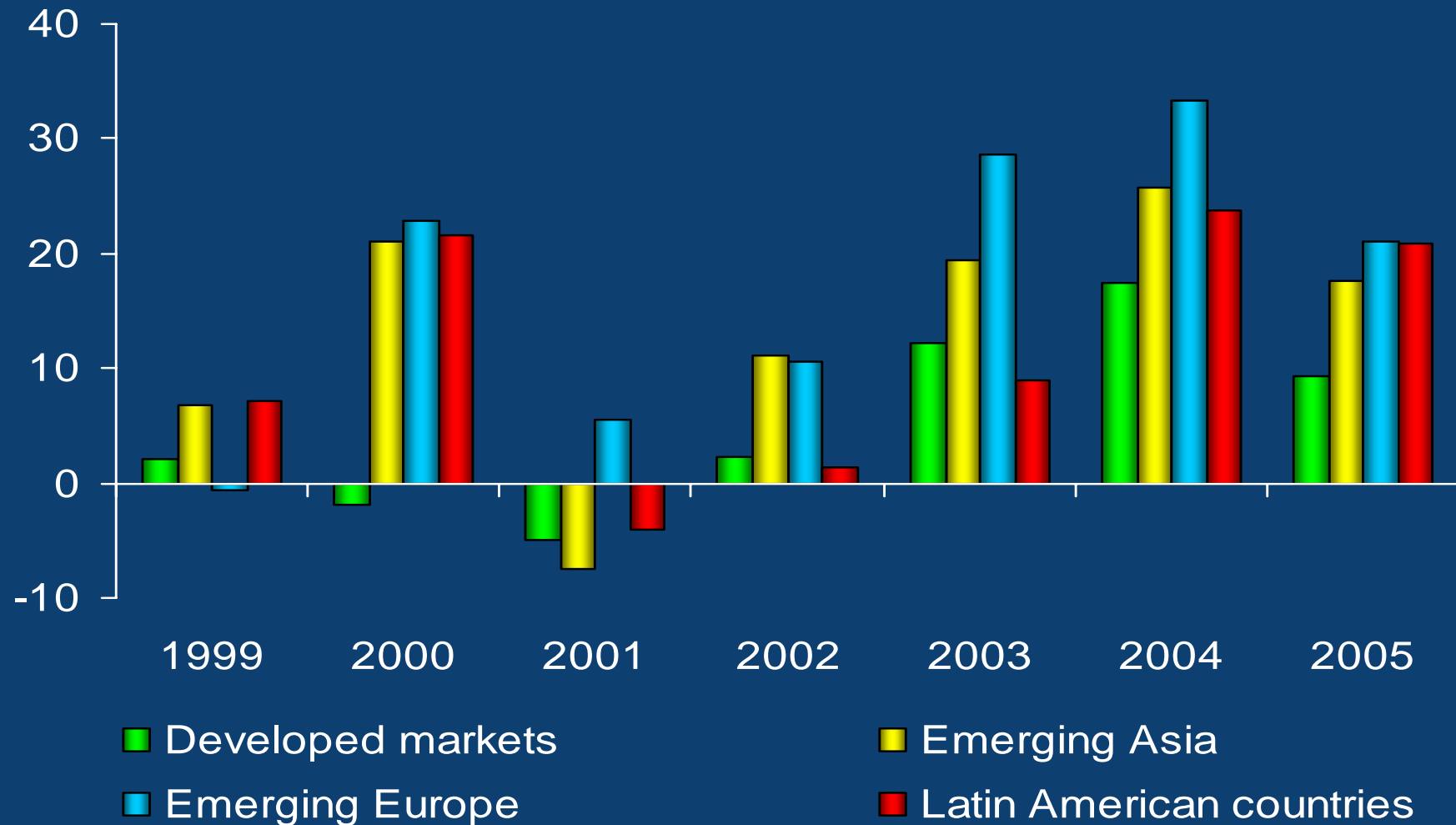
*(% of country's total exports)*

	Commodities	Oil	Metals	Agriculture
Latin American Countries	41	18	11	9
Argentina	63	18	2	25
Brazil	46	6	16	24
Mexico	16	13	3	1
Chile	76	0	53	8
Colombia	60	26	16	18
Ecuador	72	56	0	16
Peru	69	5	55	9
Venezuela	82	82	0	0

Sources: Official sources and JP Morgan Chase.

# Merchandise exports

(% yoy)



Source: JP Morgan Chase.

# Economic Growth

(% yoy)

	1990s	Average 2000-03	2004	2005	2006 (f)
Argentina	4.3	-1.8	9.0	9.2	7.7
Brazil	1.8	2.0	4.9	2.3	3.5
Chile	6.4	3.5	6.1	6.3	5.3
Colombia	2.9	2.6	4.8	5.2	4.7
Mexico	3.4	2.2	4.4	3.0	4.4
Peru	3.2	3.0	4.8	6.4	5.8
Average LAC	2.8	1.7	5.6	4.2	4.8

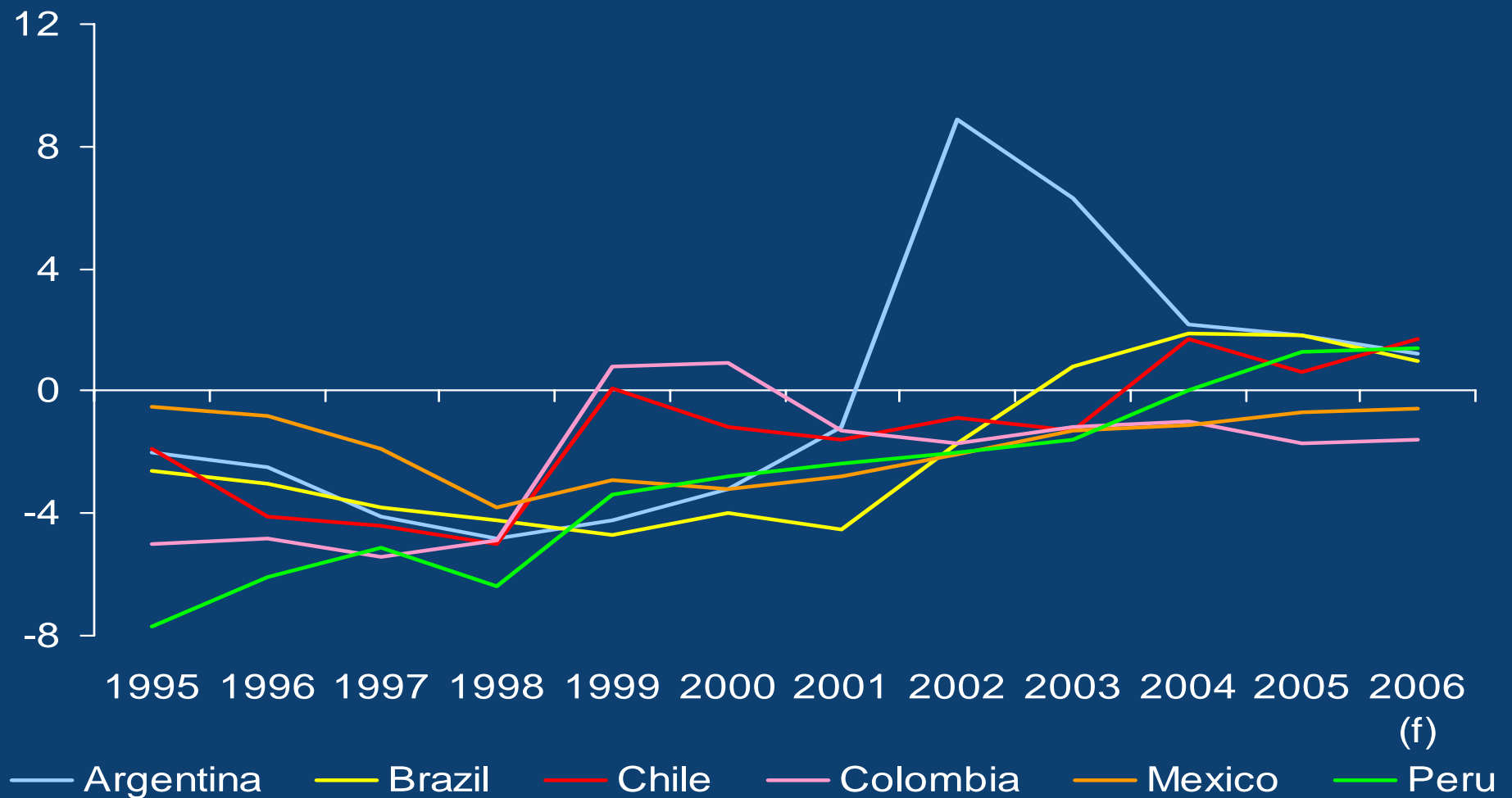
(f) Forecast.

Sources: Consensus Forecasts (August 2006).

# Short Term Prospects

- Most countries in the region achieved current account surpluses, which in part reflects prudent domestic spending in a context of higher income resulting from export prices.
- Net inflows of foreign direct investment and portfolio investment to the region have shown a rebound relative to the previous two years, but still below 2000 levels.
- An improvement in the structure of foreign debt in the direction of longer maturities is also apparent.

# Current Account (% GDP)



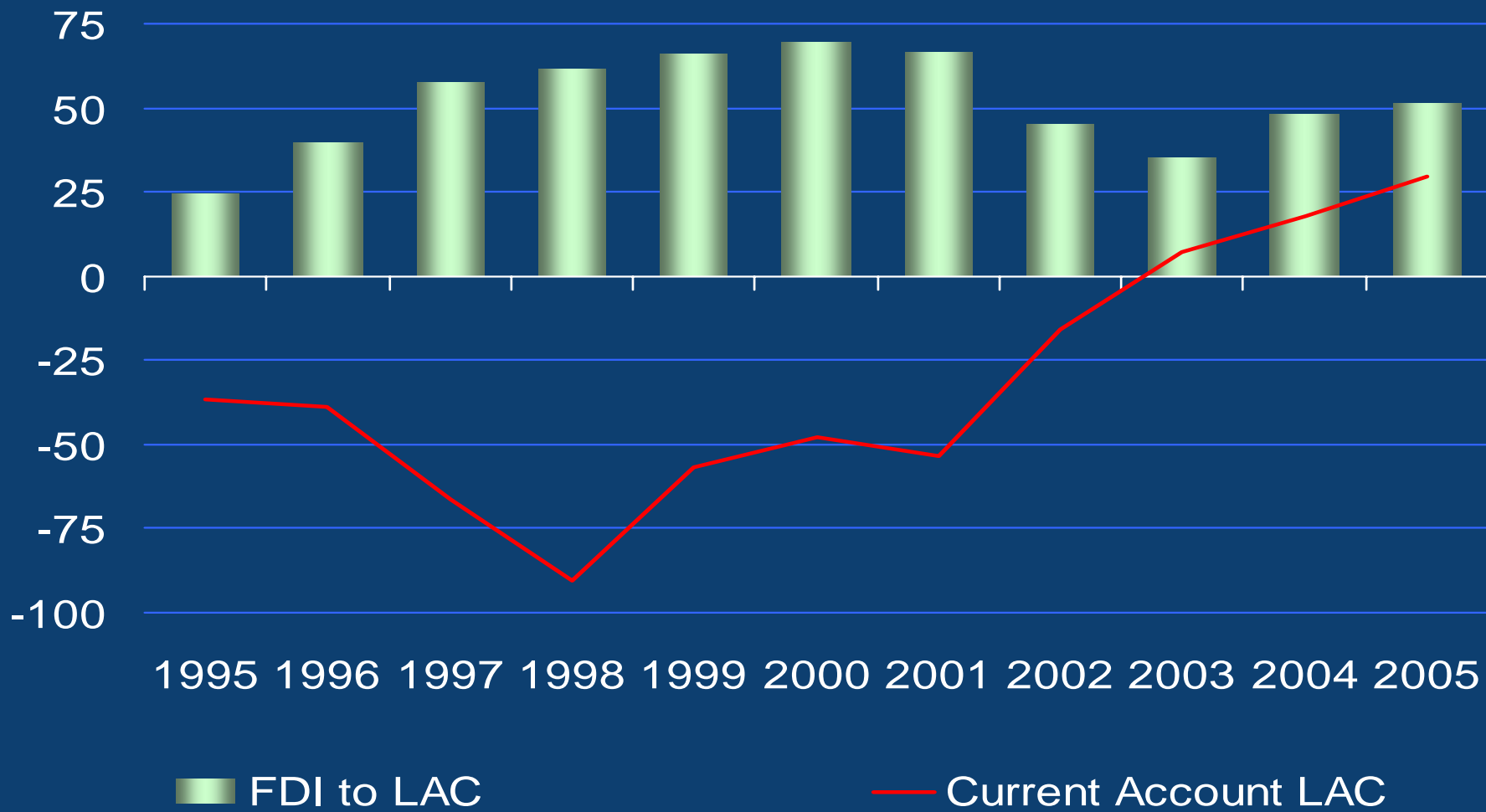
(f)

(f): Forecast.

Sources: IMF, Central Bank of Chile.

# Current Account and FDI

(billions of US\$)



Source: WEO (April 2006).

# Short Term Prospects

- Prudent macroeconomic management has stimulated market confidence with respect to the quality of economic policies in the region.
  - ▲ This is a major difference with previous economic cycles.
- However, the region is still exposed to possible external shocks:
  - ▲ Slower world growth;
  - ▲ Higher oil prices;
  - ▲ Sudden unwinding of global imbalances.
- Notwithstanding, Latin America is better prepared than in the past to absorb these shocks.

# Short Term Prospects

- Mexico has made important progress in macro stability but has suffered competition from China together with lack of domestic consensus on important structural reforms.
- Brazil has also made substantial progress in terms of macro stability, but efforts are needed to stimulate higher economic growth by improving investment and trade openness of the economy.
- Argentina continues to exhibit high growth rates, but inflation is accelerating and capacity gaps are being exhausted.
- Peru is benefiting from low and stable inflation, a dynamic export sector and the recovery of private investment.

### 3. Chile



# Economic model

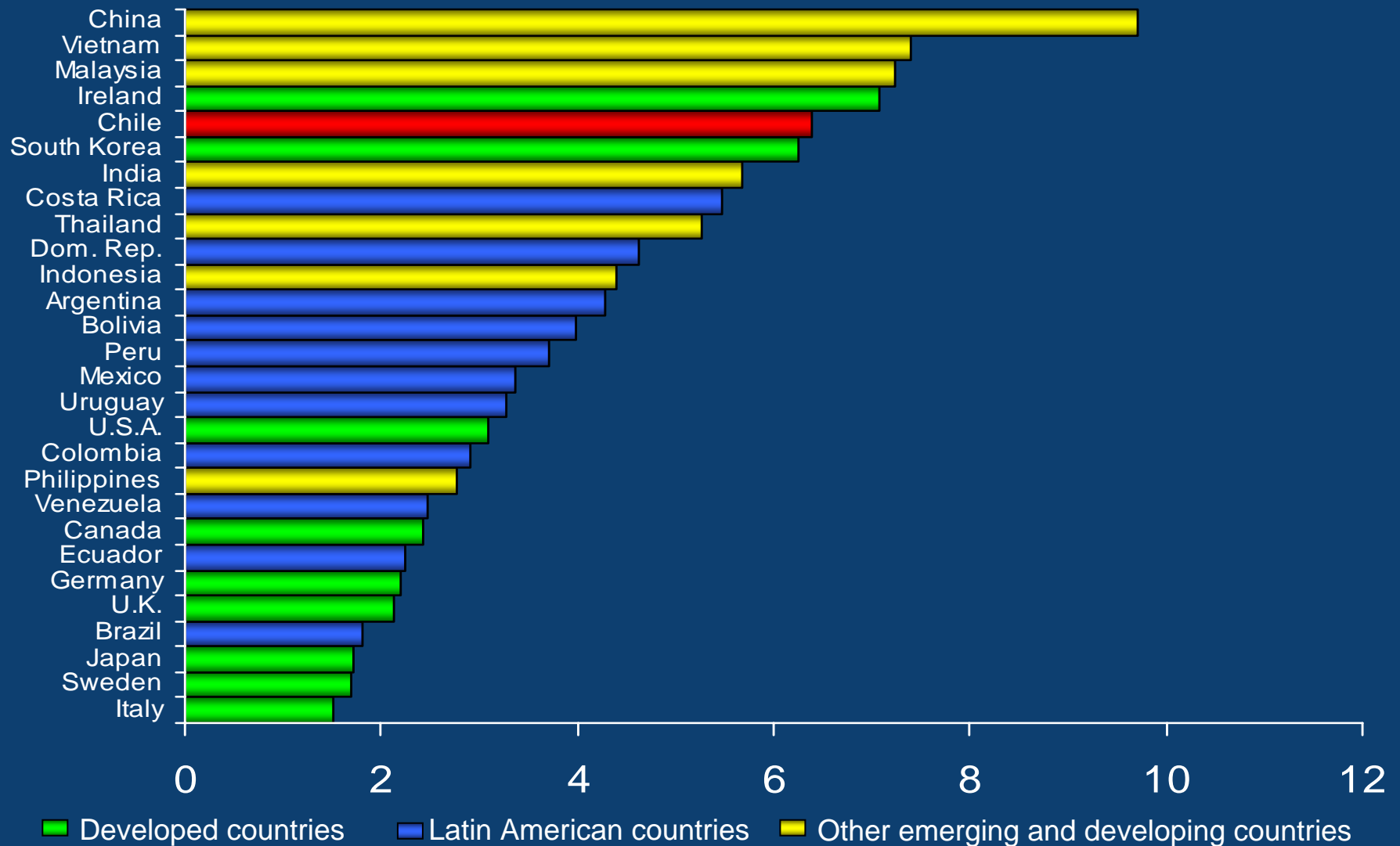
- The economic model built along the last three decades is the main rationale behind Chile's outstanding economic performance of the past twenty years, and its differentiation from the rest of Latin America.
- The model is founded on five main pillars:
  - ▲ Macroeconomic stability with autonomous Central Bank & solvent fiscal sector;
  - ▲ Robust and sound financial sector;
  - ▲ Strong and stable institutional setting;
  - ▲ Competitive open-market economy;
  - ▲ Comprehensive social network.

# Economic performance

- During the 1990s, Chile was among the fastest-growing economies in the world.
  - ▲ Largely due to efficiency gains.
- Extraordinary growth rates allowed Chile to close per-capita income gap with developed countries by 30% in twenty years.
  - ▲ This stands in sharp contrast with the experiences of other countries in Latin America.
  - ▲ However, there is still a long road to travel to match the performance of other developing countries, especially in Asia.

# Economic Growth during the 1990s

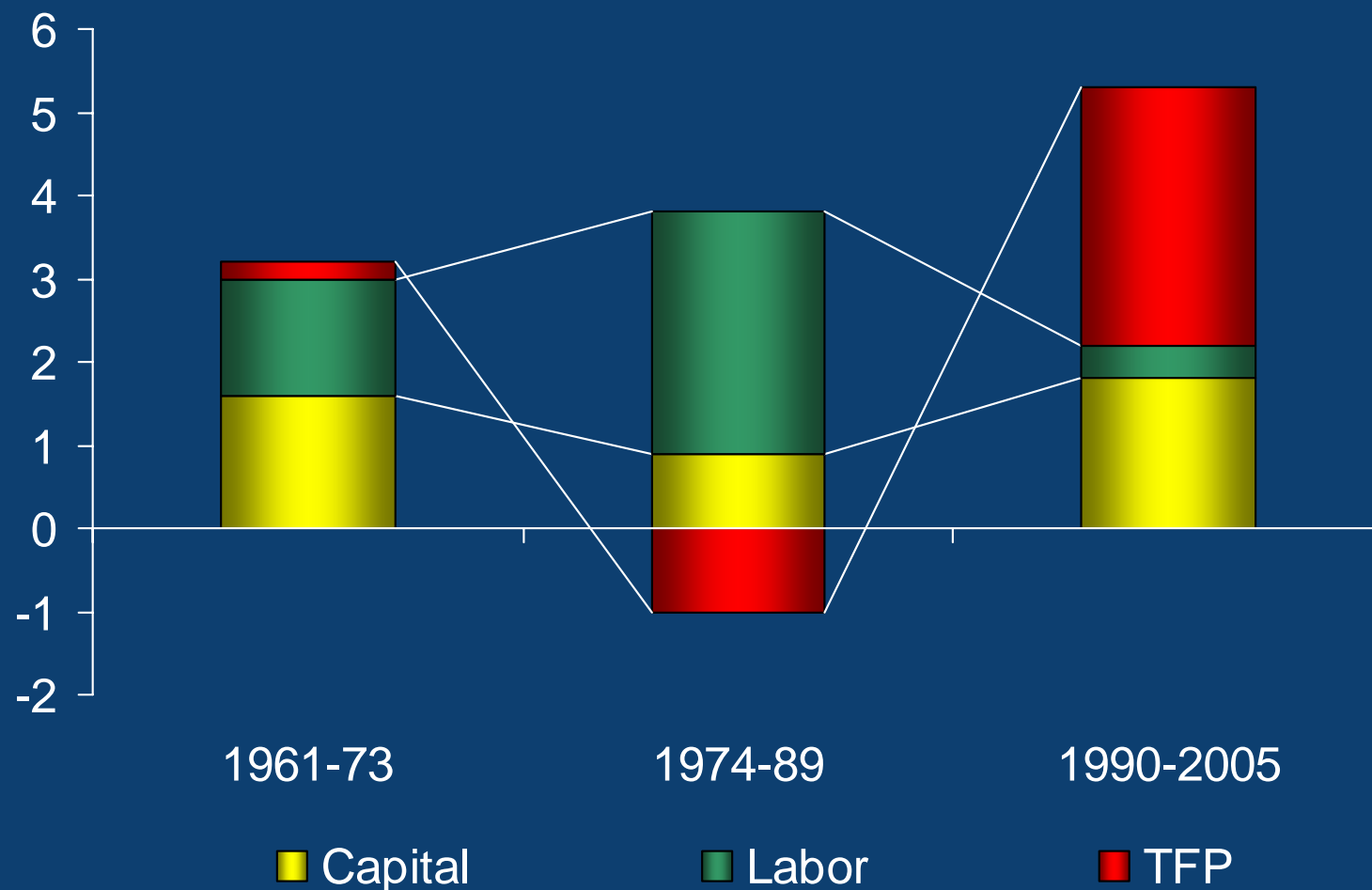
*(annual average, %)*



Source: WEO (April 2006).

# Solow's Decomposition of Economic Growth

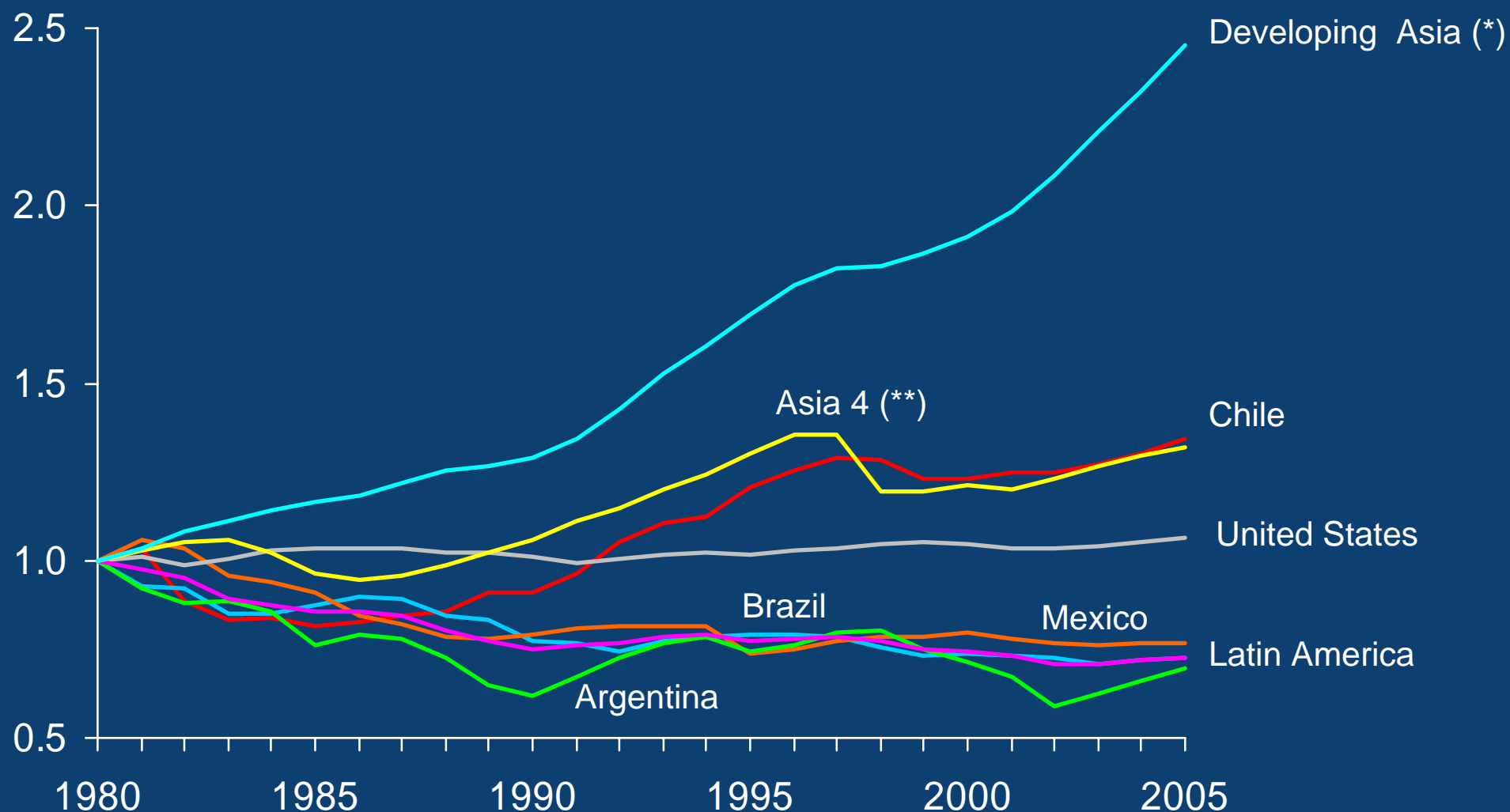
(Chile, %)



Source: Fuentes, Larrain and Schmidt Hebbel (2004).

# Relative Per Capita Output

(per capita GDP over per capita GDP of G-7, PPP; 1980=1)



(\*) Includes China and India (\*\*) Considers Malaysia, Indonesia, Thailand and Philippines.  
Source: Own calculations.

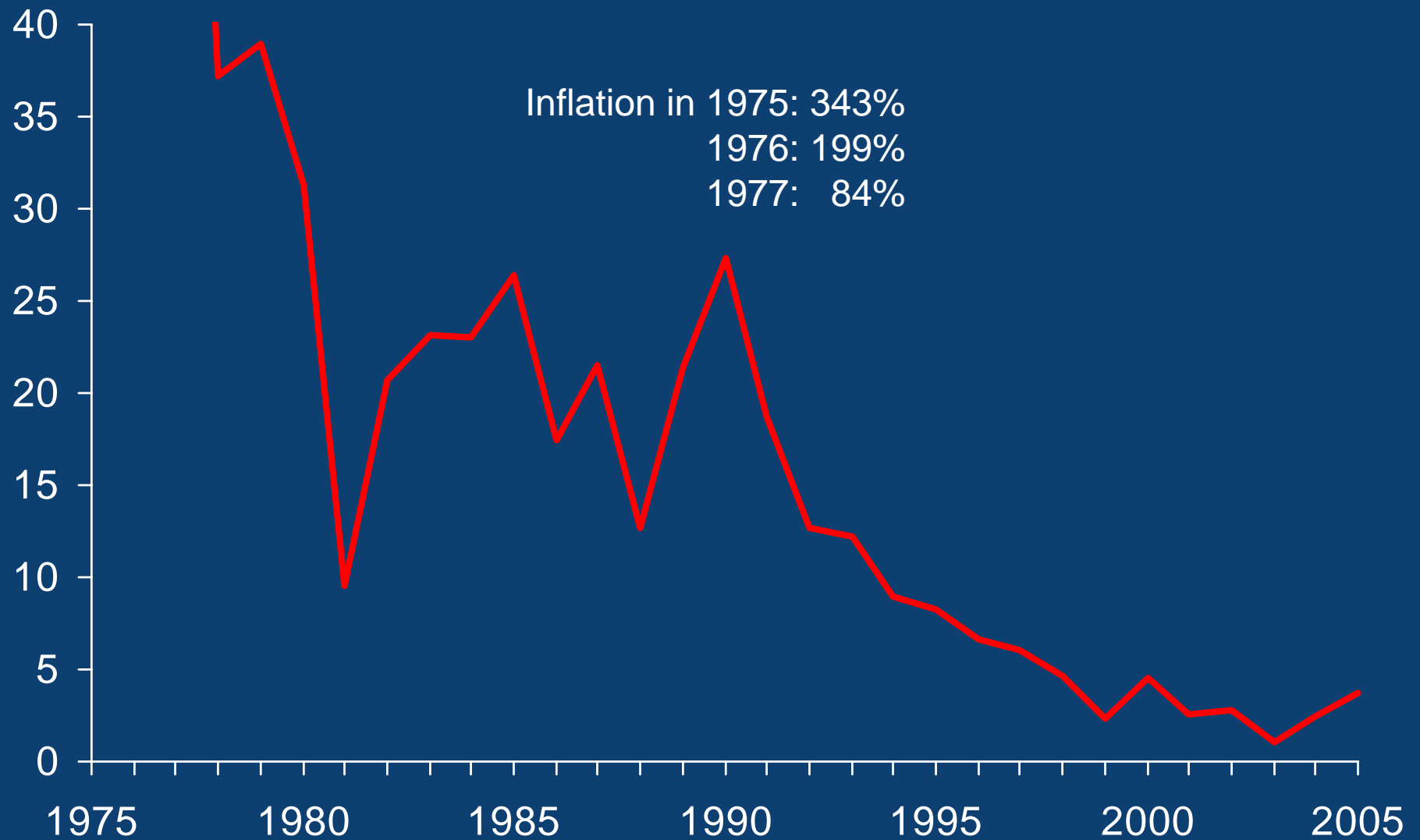
# Economic performance

## ➤ Moreover:

- ▲ Inflation experienced a gradual reduction, approaching industrial-country levels.
  - ▲ Strong fiscal discipline was achieved, with budget surpluses during the most part of the last two decades.
- ## ➤ Fast expansion of this period allowed Chile to cut the incidence of poverty in half in fifteen years.
- ## ➤ Also, other social indicators such as mortality rate and life expectancy have improved substantially.

# Inflation Rate

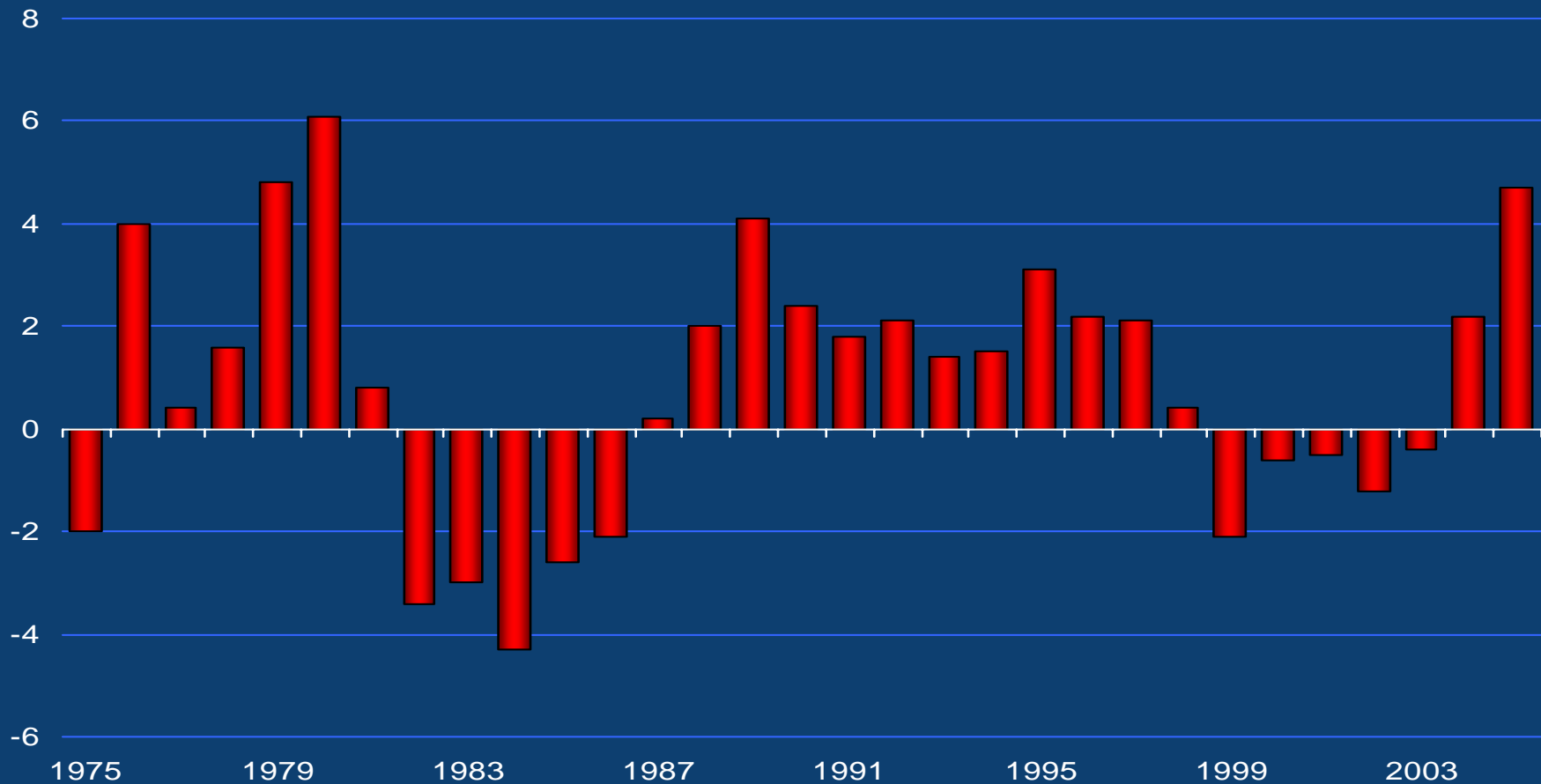
*(December-December, %)*



Source: Central Bank of Chile.

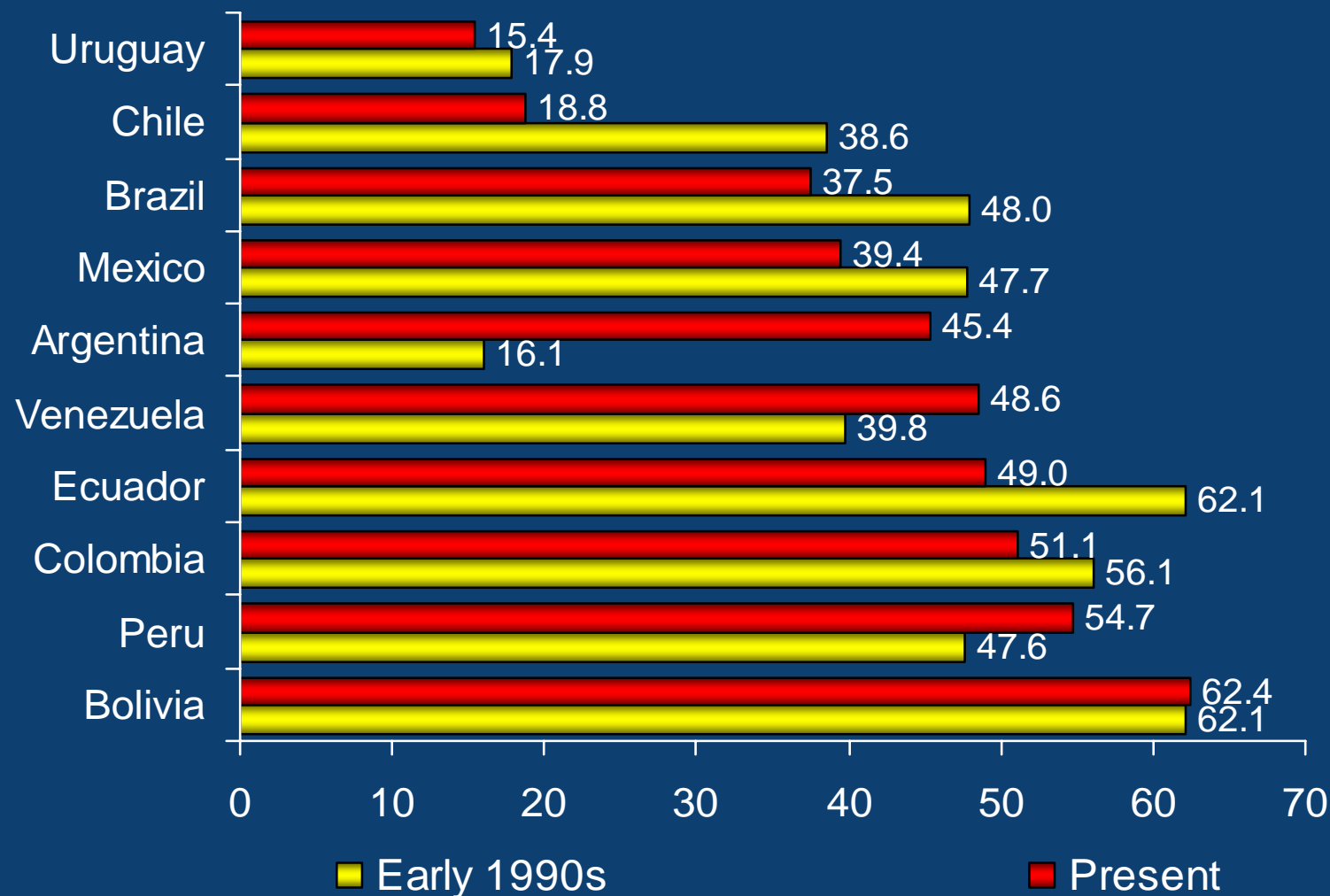
# Fiscal Balance

(1975-2005, Central Government, % GDP)



Source: Chile's Ministry of Finance.

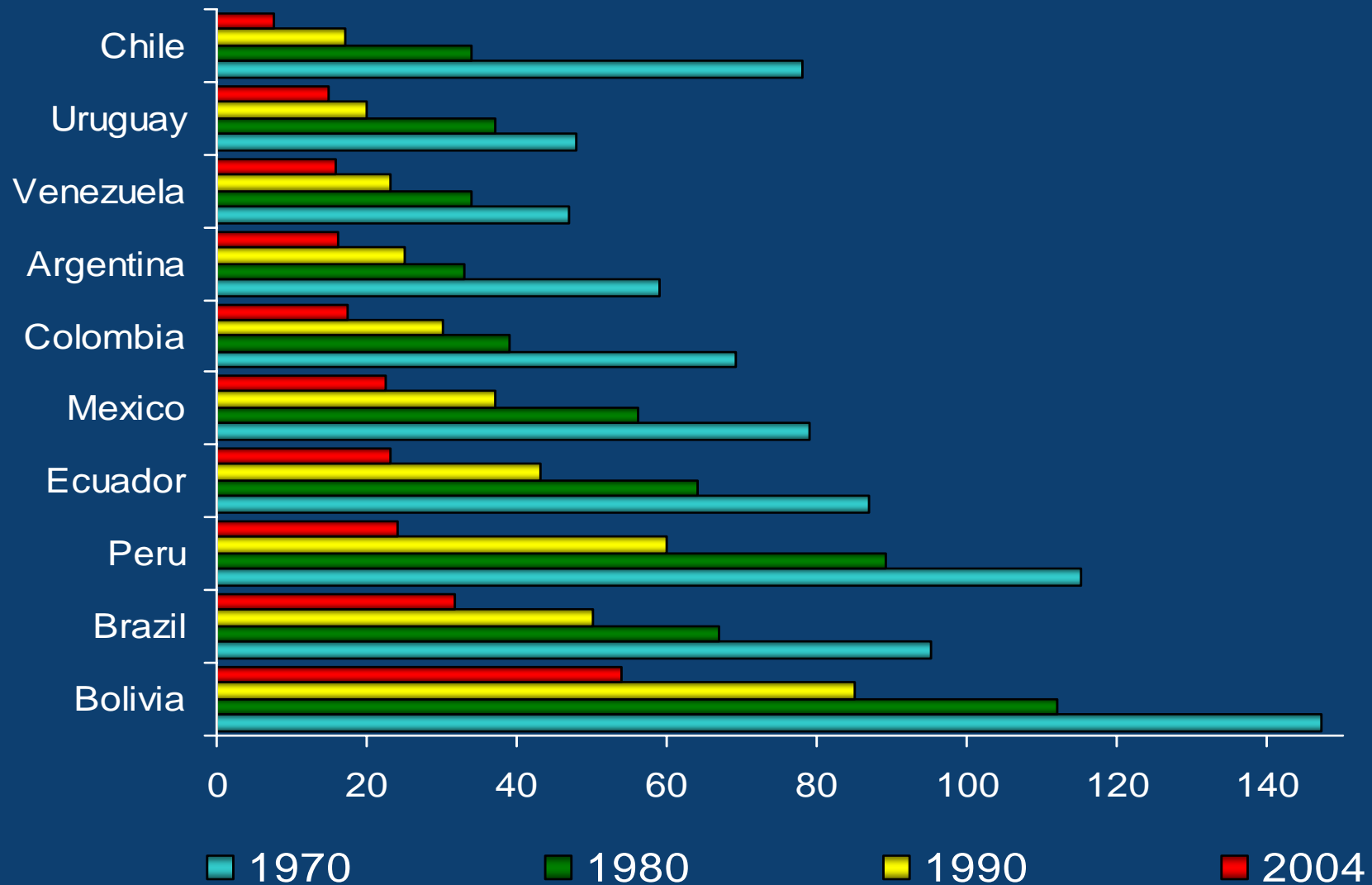
# Poverty Rate (%)



Note: Present stands for the years 2002 or 2003, depending on the country.  
Sources: ECLAC (2004) and MIDEPLAN (2005).

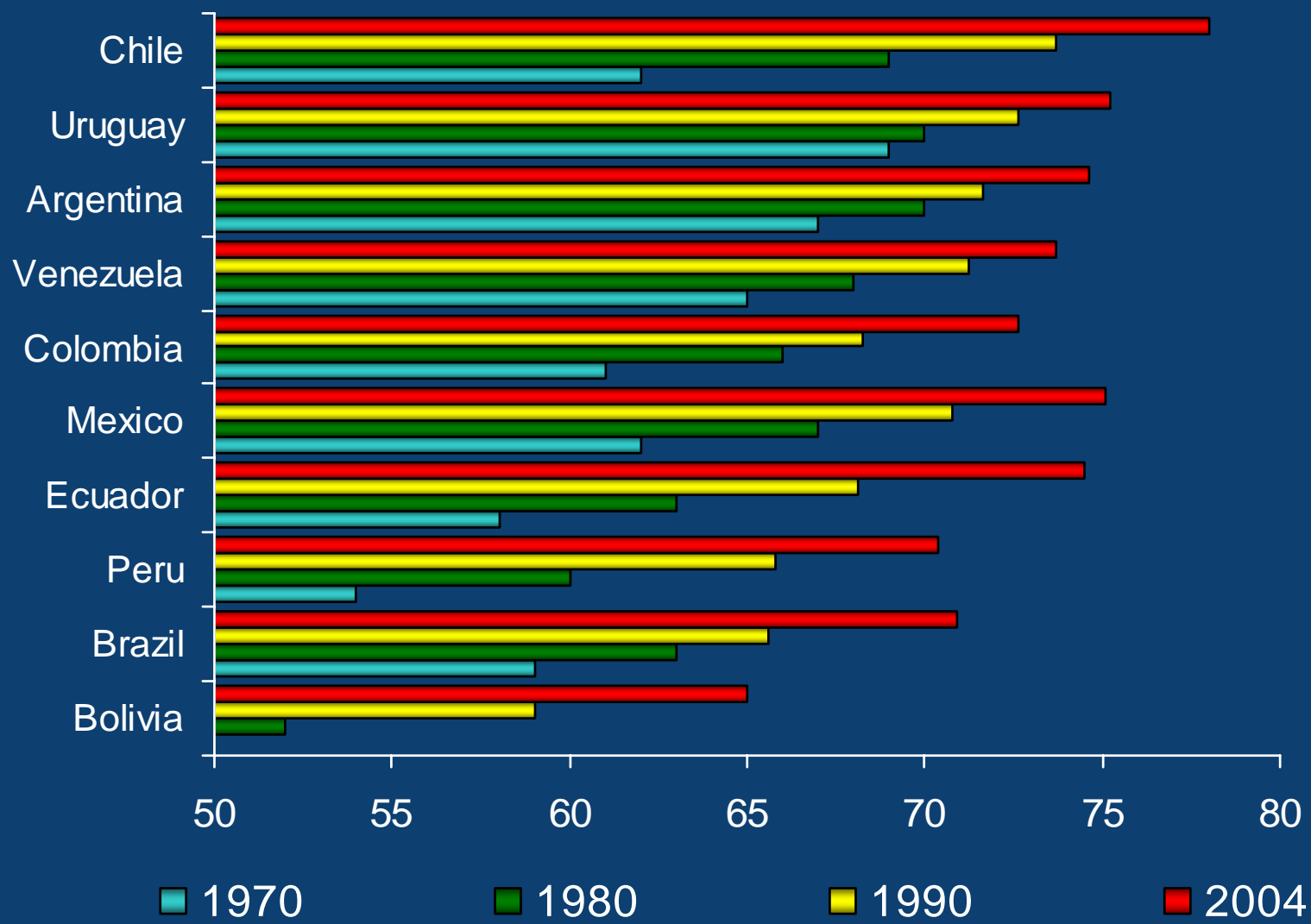
# Infant Mortality

*(per 1000 live births)*



Source: World Bank, WDI 2005.

# Life Expectancy at Birth (years)



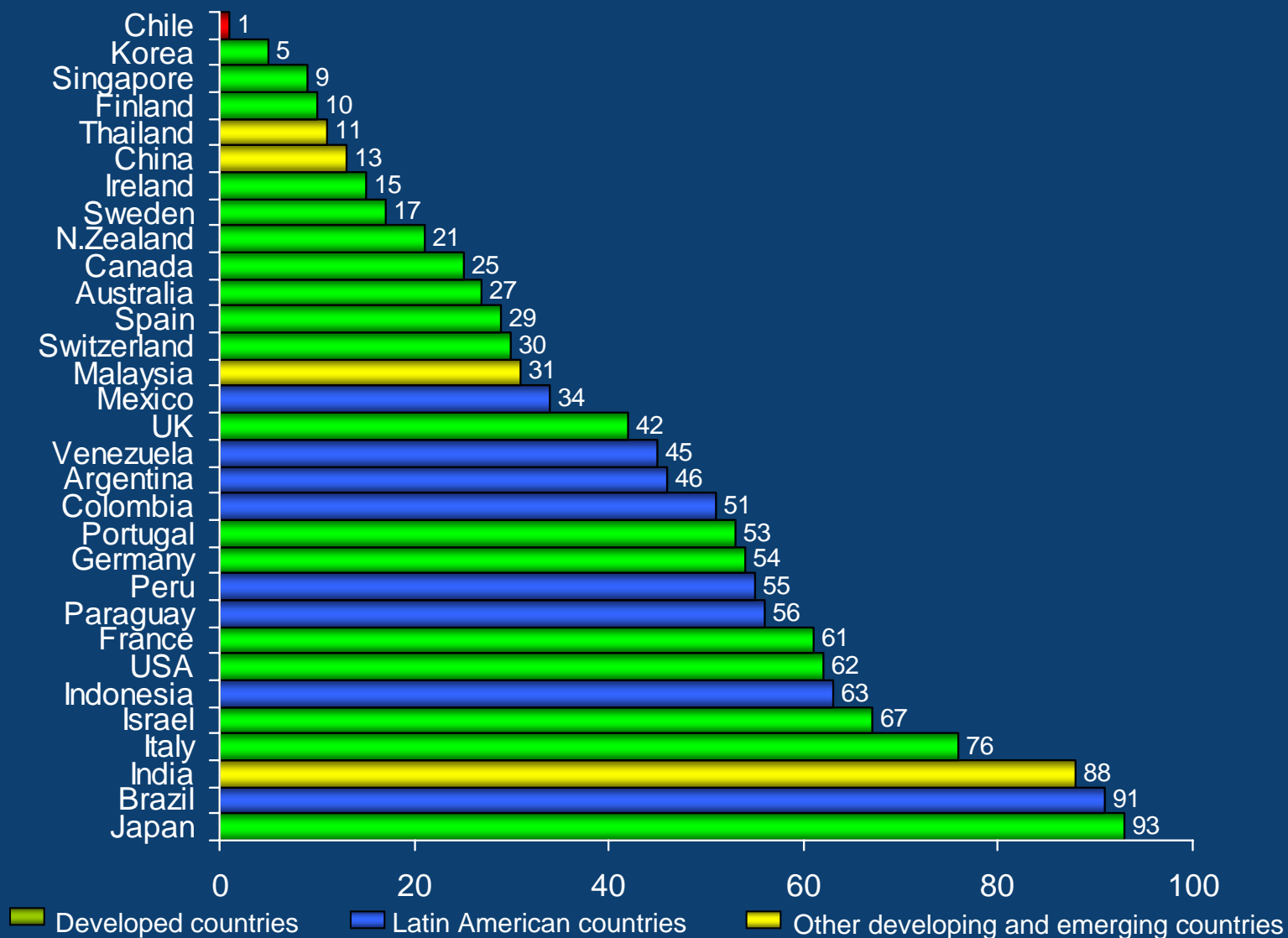
Source: World Bank, WDI 2005.

# Main strengths

- As a result of all of the above, Chile is today better prepared than in the past (and than other emerging economies) to accommodate shocks.
- Chile's main strengths include:
  - ▲ Proven macroeconomic framework;
  - ▲ Solid fiscal balance and very low public debt;
  - ▲ Robust financial system;
  - ▲ Strong institutions (e.g., rule of law, independent Central Bank).

# Macroeconomic Management

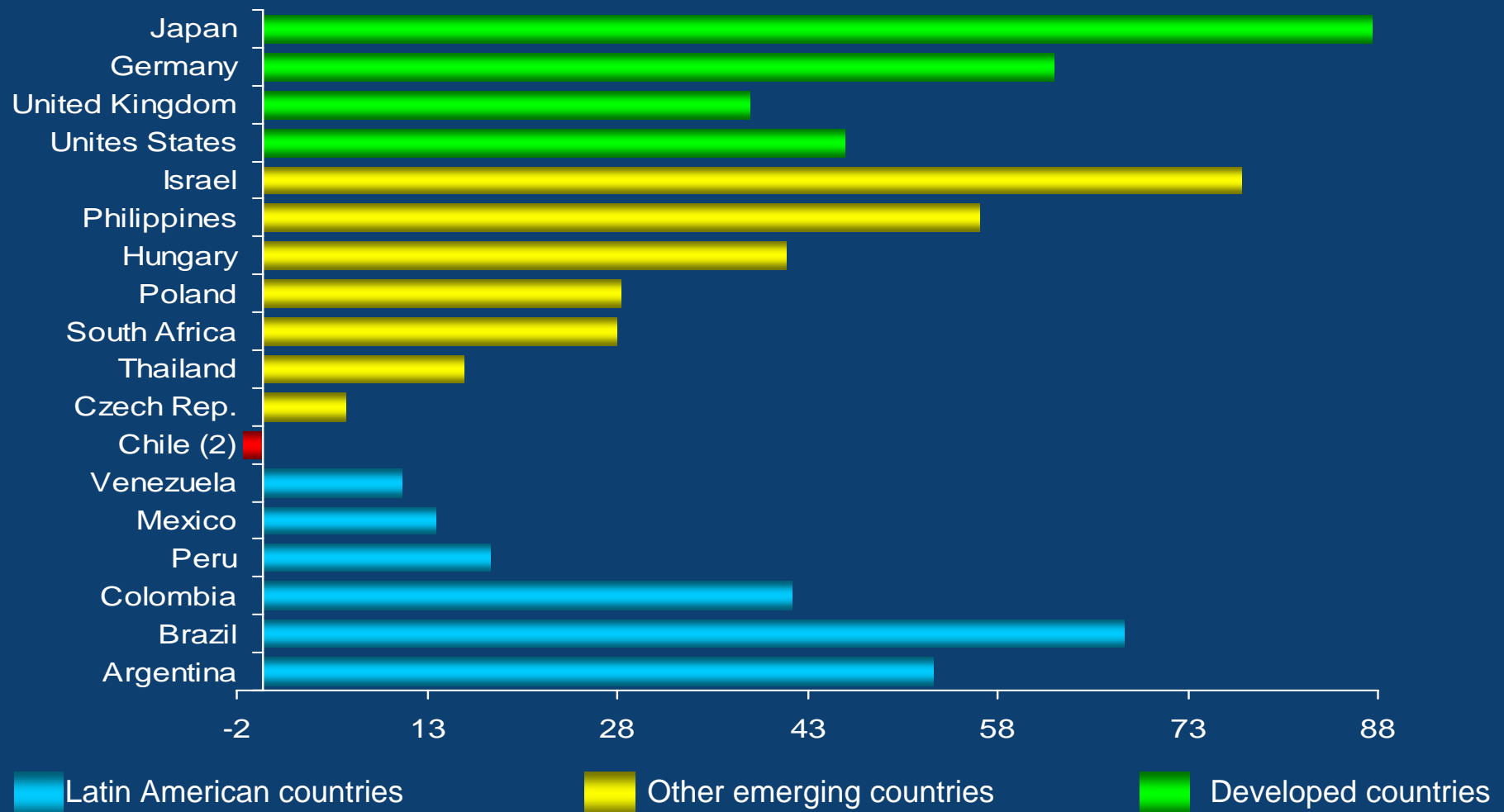
(ranking, 2005)



Source: The Global Competitiveness Report 2005-2006.

# Public Debt 2005 <sup>(1)</sup>

## (% GDP)



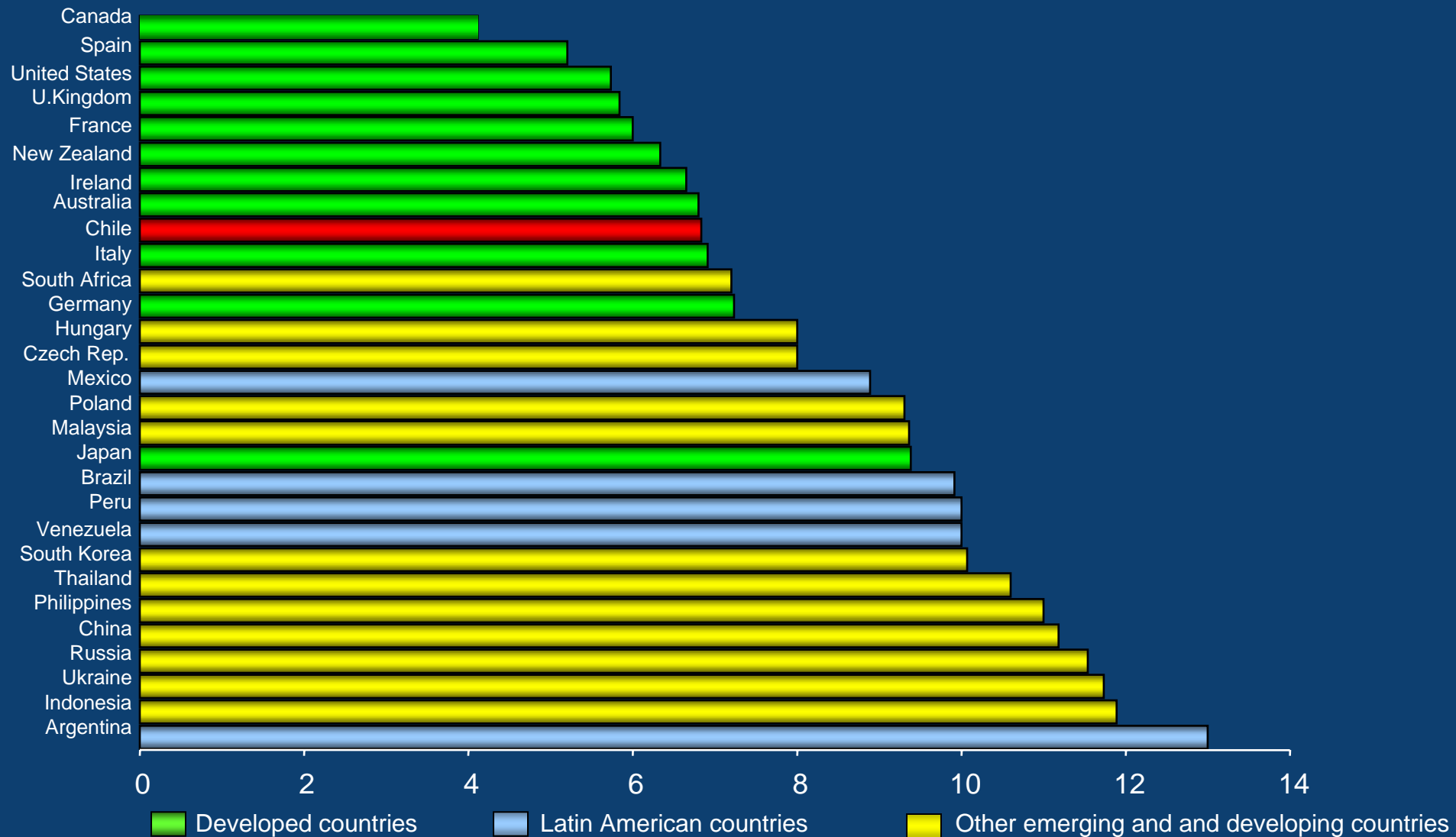
(1) Net Central Government Debt (excludes Reserves, Central Bank Debt and Social Security Trust Funds).

(2) Net Central Government Debt achieves -1.6% as of March 2006.

Sources: Moody's, JP Morgan Chase, IMF and Ministry of Finance of Chile.

# Banking Strength

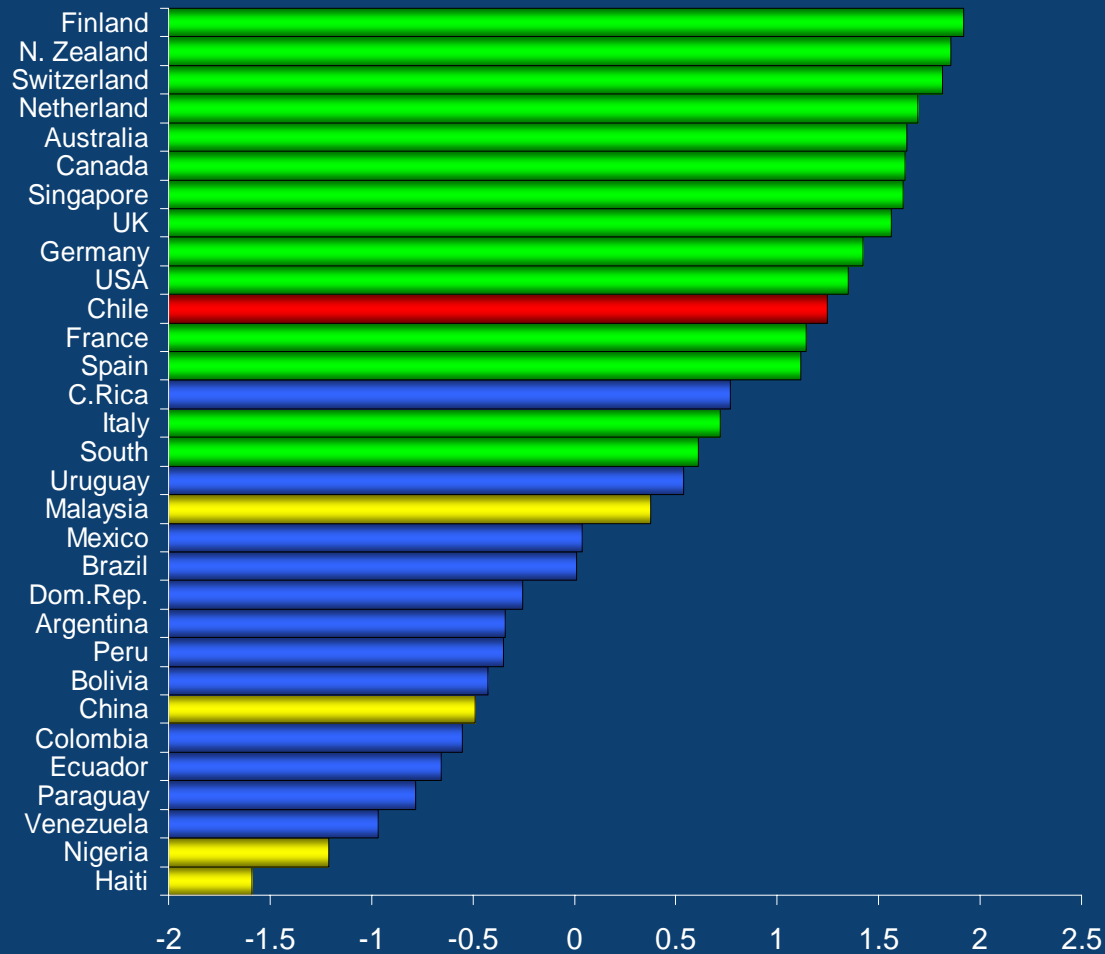
(index, 2005)



Source: Central Bank of Chile (based on Moody's Financial Strength Ranking, May 2006).

# Quality of Institutions

(index, 2004)

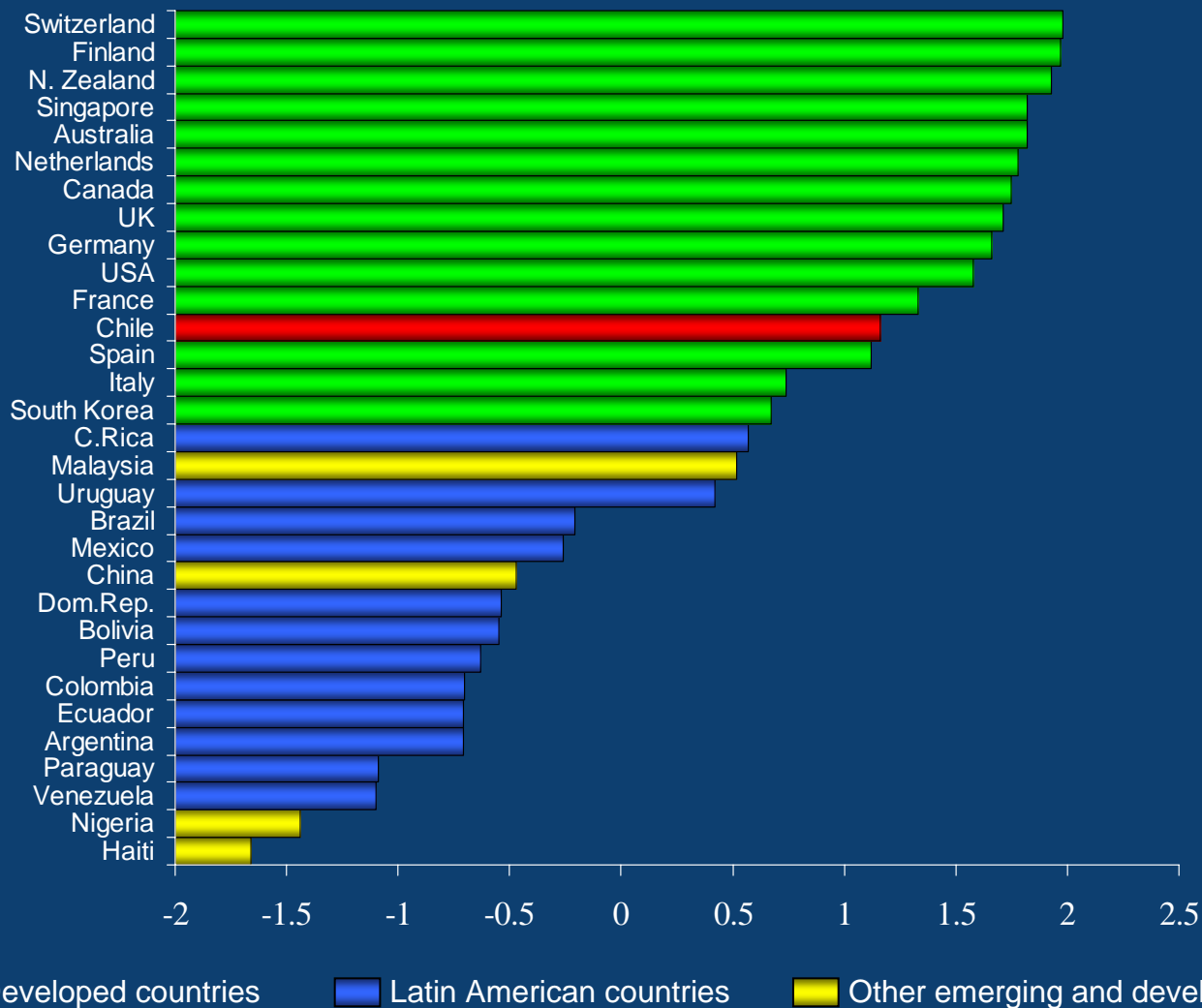


■ Developed countries
 ■ Latin American countries
 ■ Other emerging and developing countries

Note: Average of six indexes: rule of law, corruption control, political stability, quality of regulations, government effectiveness and accountability.  
 Source: World Bank (2005).

# Rule of Law

(index, 2004)



Developed countries Latin American countries Other emerging and developing countries

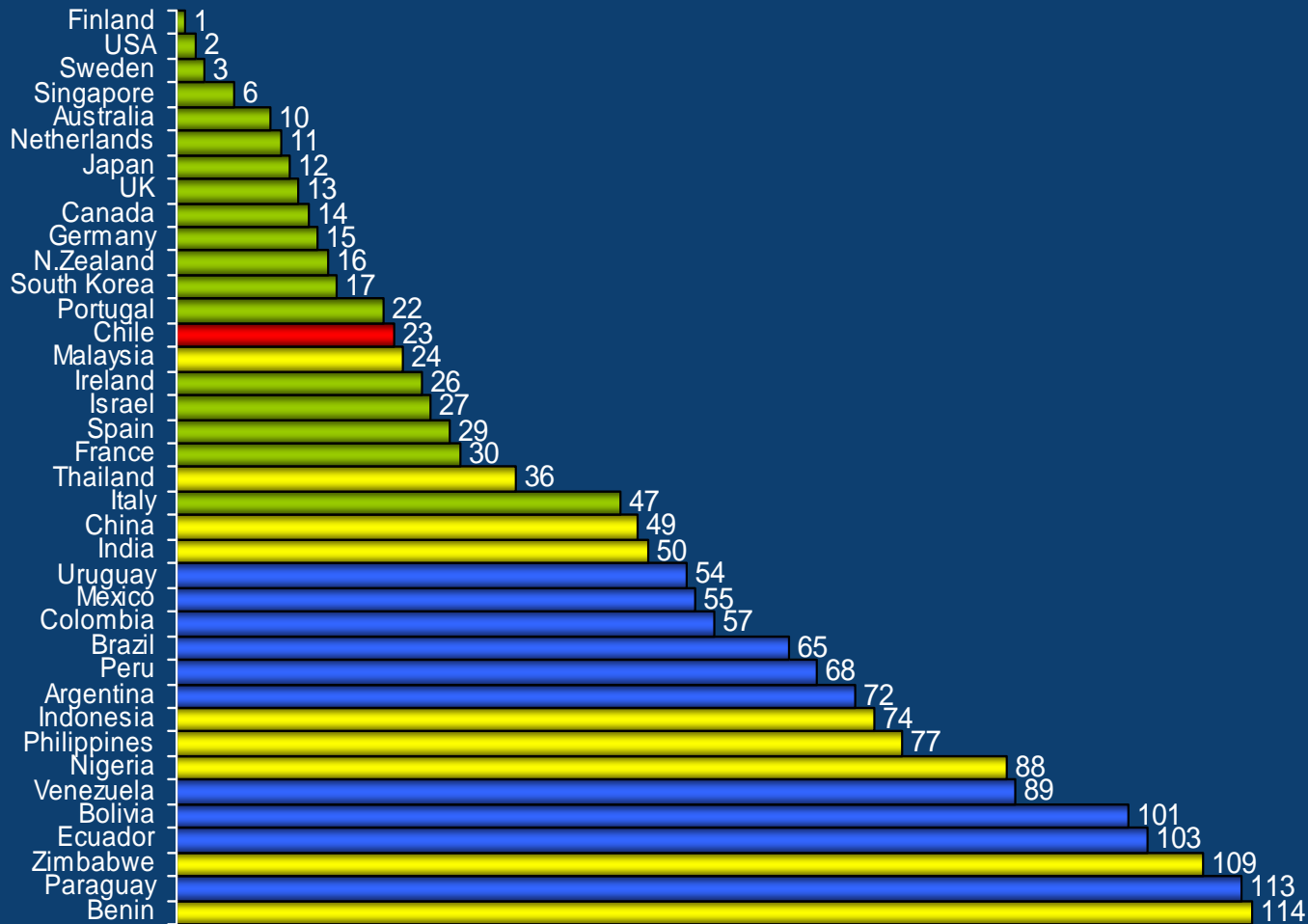
Note: Index measures protection of individuals and property against violence or theft, independent and effective judges, and contract enforcement.  
Source: World Bank (2005).

# Main strengths

- Today Chile stands out among emerging market economies:
  - ▲ As one of the most competitive;
  - ▲ Among the lowest country-risk ratings.
- Moreover, the World Bank's report on the ease of doing business ranks Chile 25<sup>th</sup> among 155 countries in 2005.
  - ▲ Chile is at top of the list in the region.

# Competitiveness

(index, 2005)

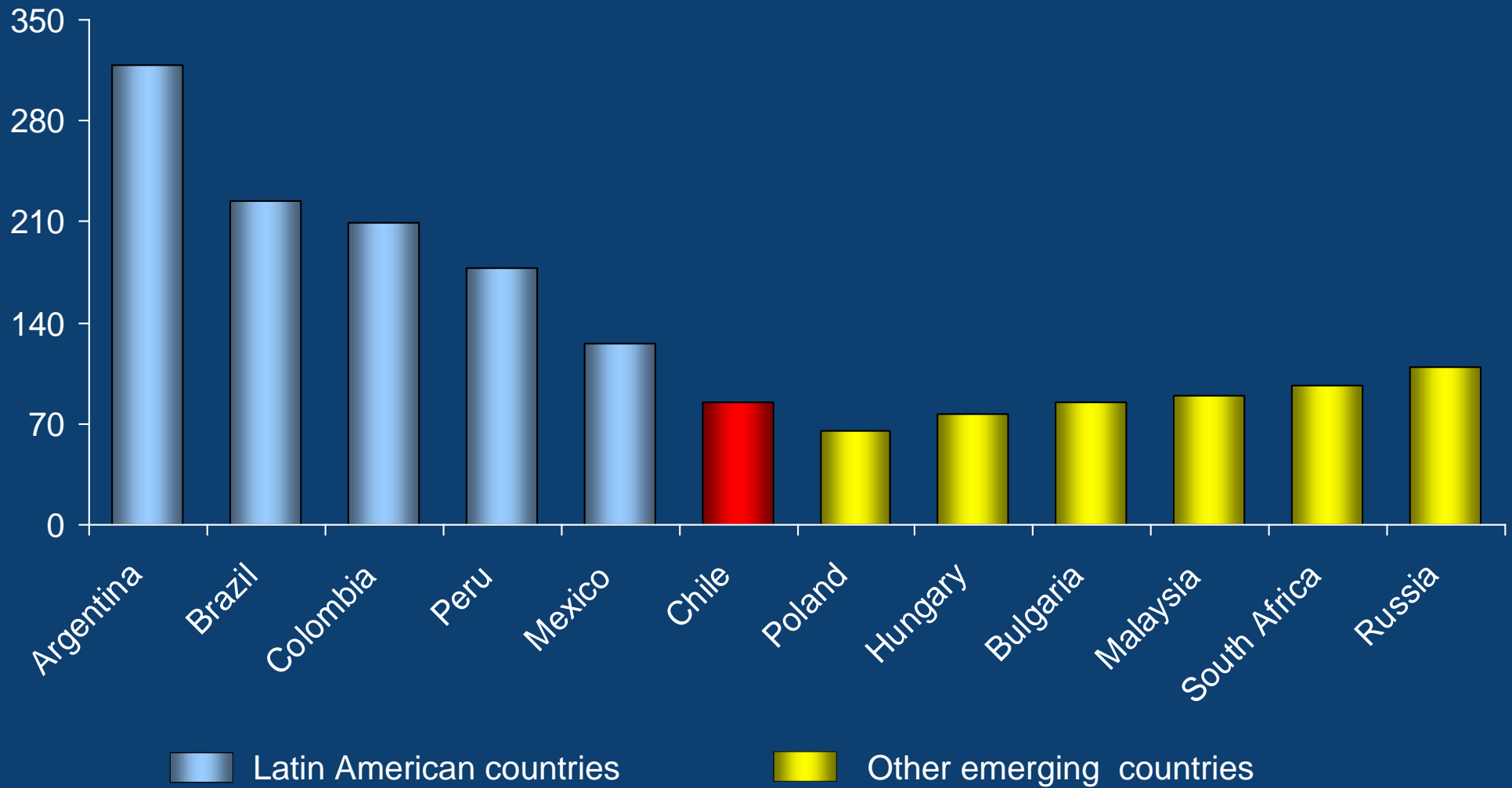


■ Developed countries
 ■ Latin American countries
 ■ Other developing and emerging countries

Note: The competitiveness index measures country's ability to achieve high and sustainable per capita GDP growth.  
 Source: World Economic Forum (2005).

# Country Risk

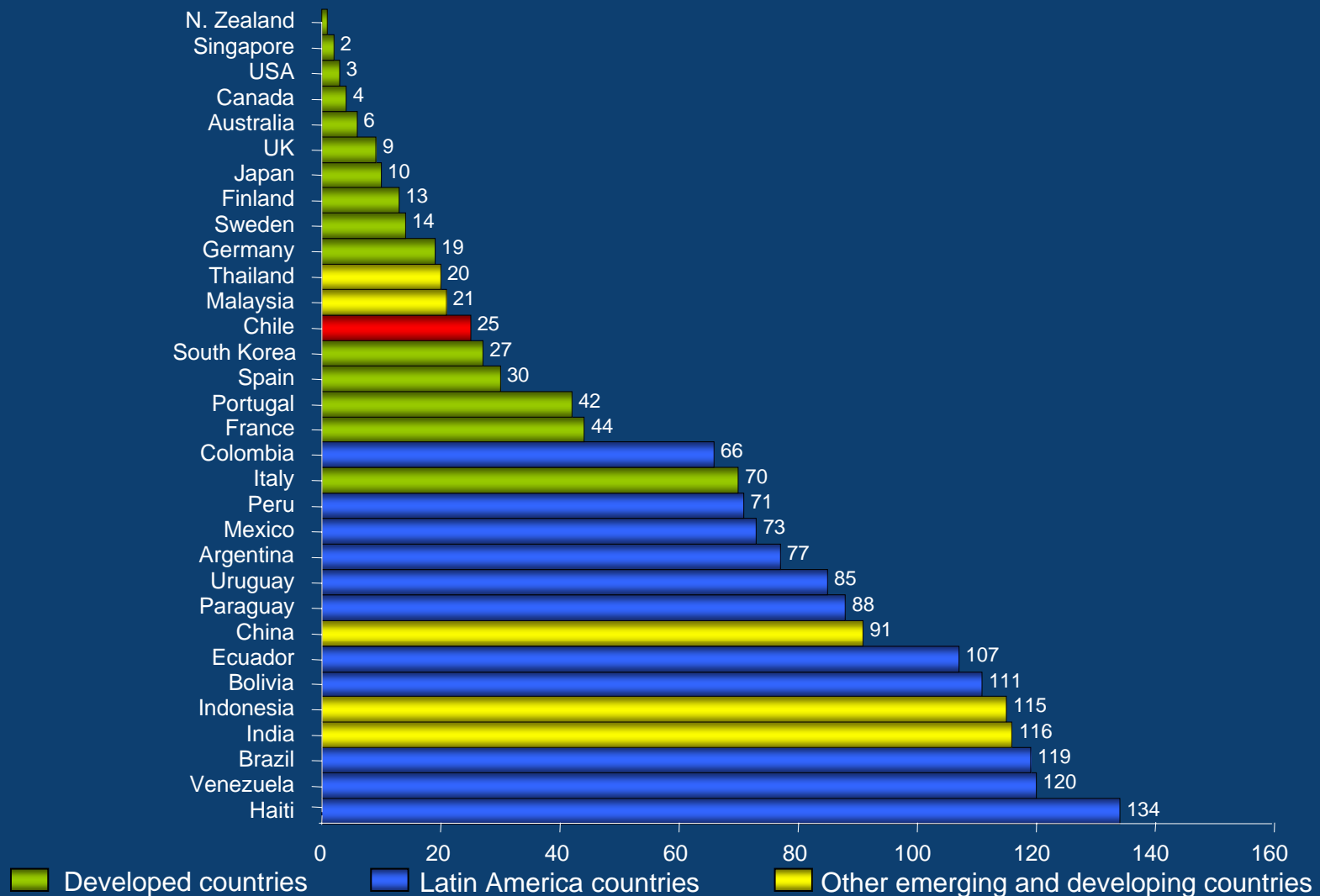
(As of August 2006, bp)



Source: JP Morgan (2006).

# Ease of Doing Business

(ranking, 2005)



Note: The ranking measures country averages across ten topics: starting a business, dealing with licenses, hiring and firing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business.

Source: World Bank (2005).

# Development is an ongoing process

- But economic development is a continuous process and Chile still faces important challenges:
  - ▲ Improve education, especially regarding quality;
  - ▲ Implement technological innovation.
- Working in these areas would allow Chile to take a new jump in TFP and reduce income inequality.
- However, in the pursuit of these objectives, special care must be given to the stability of policies and institutions that support the country's strengths.
- This is a precondition for successfully addressing the challenges of the future.

## 4. Medium Term Challenges for Latin America

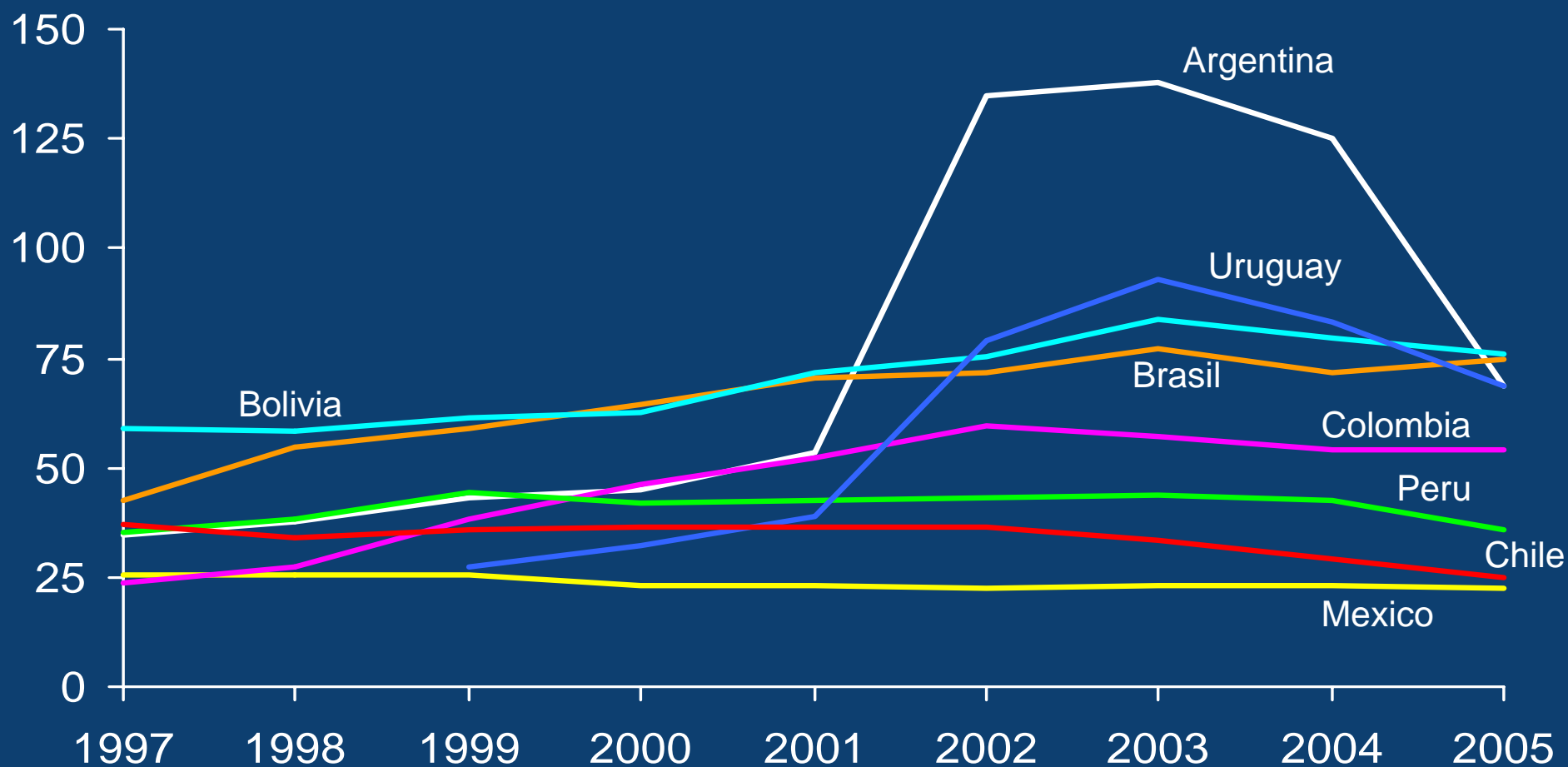


# Medium term challenges

- Major challenges are related to transforming the good short-term perspectives into sustainable growth, thus reducing income gap with developed economies.
- **How?**
  1. Consolidate macroeconomic stability:
    - ▲ Orient monetary policy at completing advances of recent years in terms of inflation reduction.
    - ▲ Public debt is still high in many economies in the region: countries must revise their tax structures, improve efficiency in tax collection and government spending, restructure debt plans and revise pension systems.

# Public Debt in Latin America

*(General Government Debt, % GDP)*



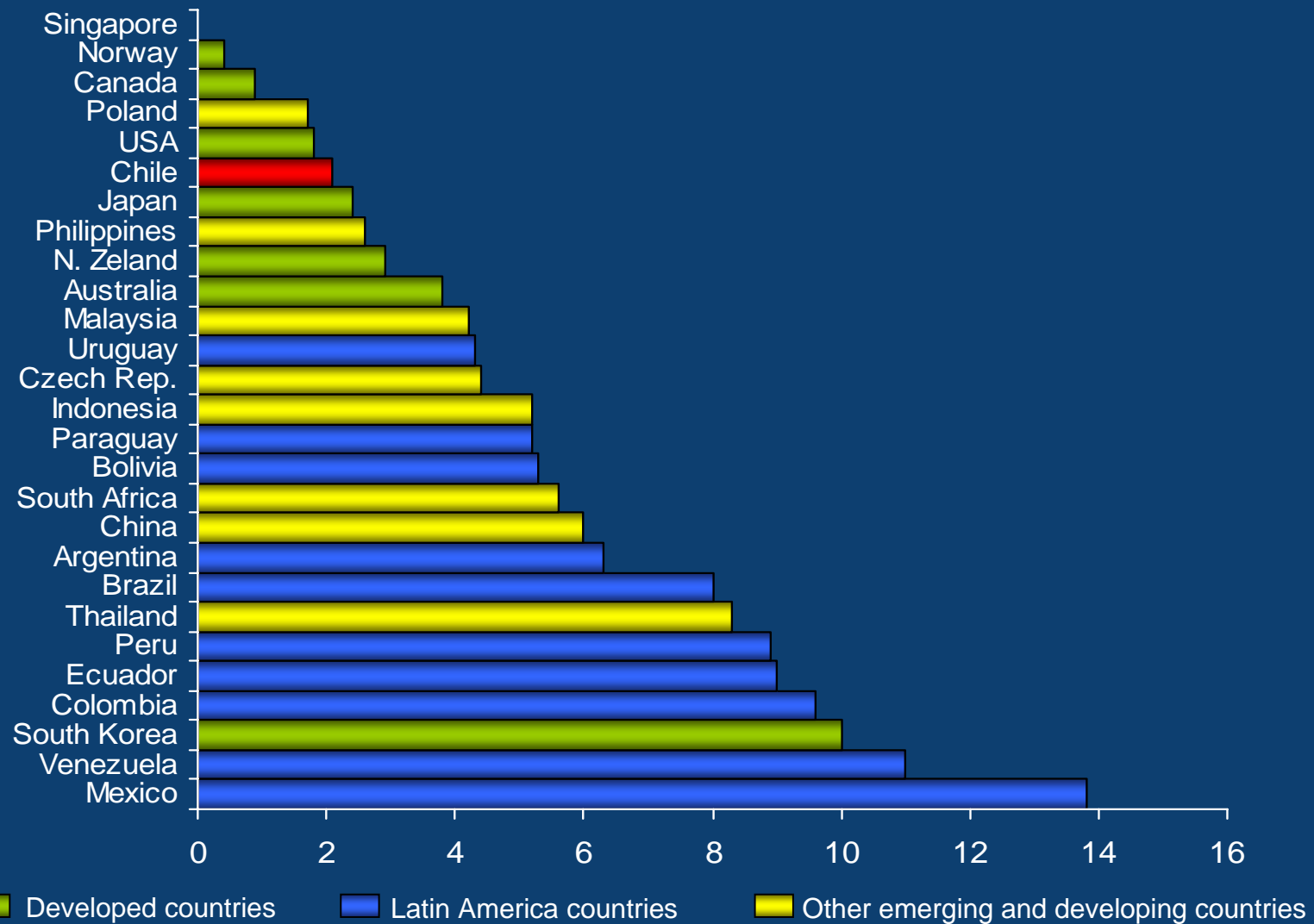
Source: Moody's and Ministry of Finance Chile (2006).

# Medium term challenges

## 2. Complete structural reforms and build strong institutional framework:

- ▶ Reduce tariff and non-tariff barriers to international trade, and facilitate access of exports to world markets;
- ▶ Increase competition and flexibility of labor markets;
- ▶ Strengthen regulation and supervision of financial systems;
- ▶ Take important steps in building solid institutions;
- ▶ Create consensus and incorporate civil society into the reform process.

# Average Import Tariffs (%)



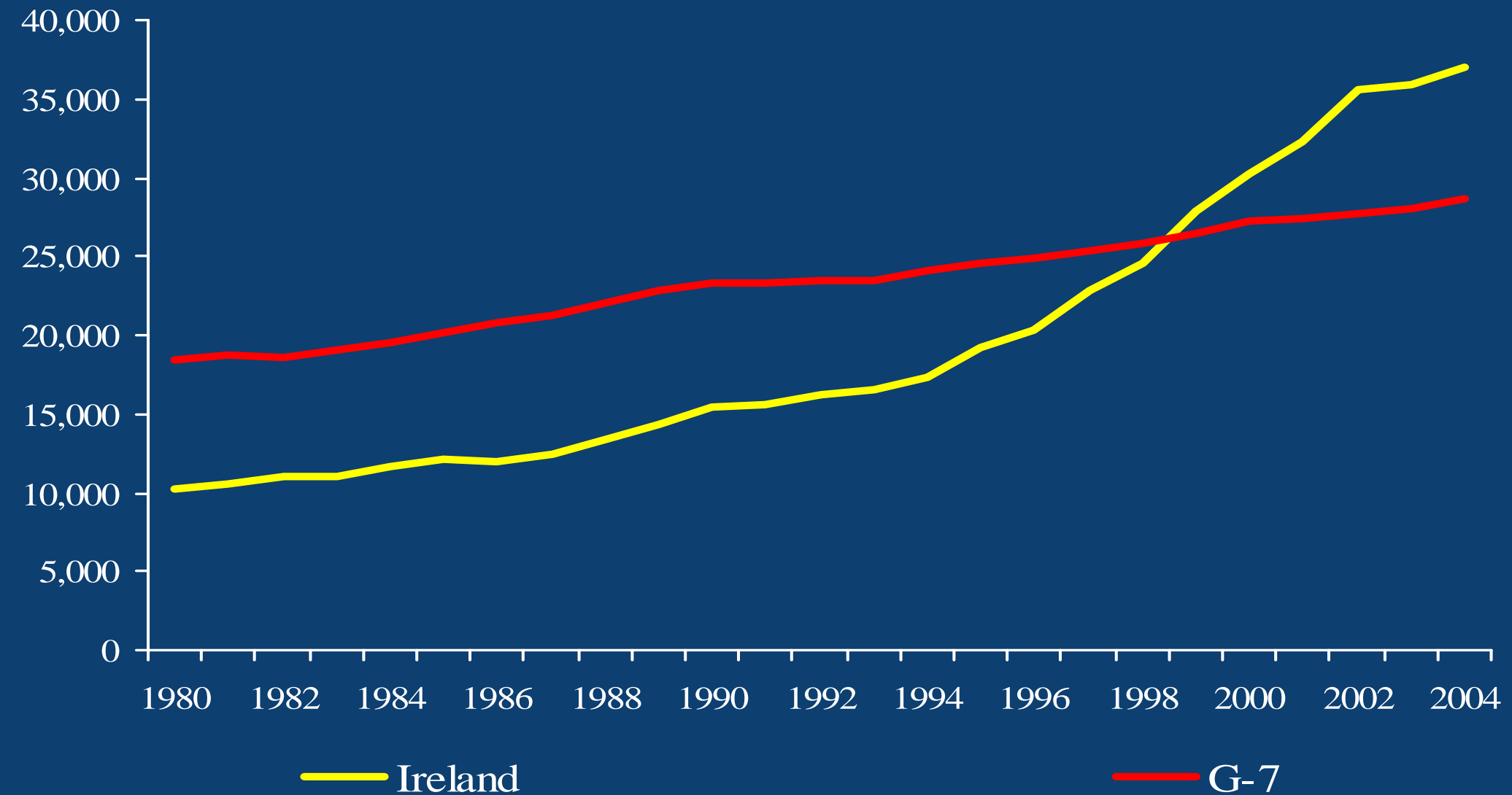
Source: World Bank, WDI (2005).

# Medium term challenges

3. Improve technological innovation processes, which will require the complement of a highly skilled labor force:
  - ▲ To close the income gap, it is necessary to go beyond basic requirements of stability, openness, competition and institutions; head-on involvement in technological innovation, education and training of the labor force is needed.
  - ▲ Ireland is a good example: Per-capita output (PPP) in 1980 was 70% that of industrial economies; today, it is 126%.

# Real Per Capita GDP

*(Ireland and G-7, 1980-2004, PPP, US\$)*



# Great opportunity for Latin America

- Latin America does not face only challenges, but also a great opportunity to take major a leap toward economic development in this global world.
- There are many success stories of low-per-capita-income countries that have attained economic development by addressing aforesaid challenges with remarkable results that are reflected in reductions in poverty rates and improved social indicators.



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